

Chapter 4

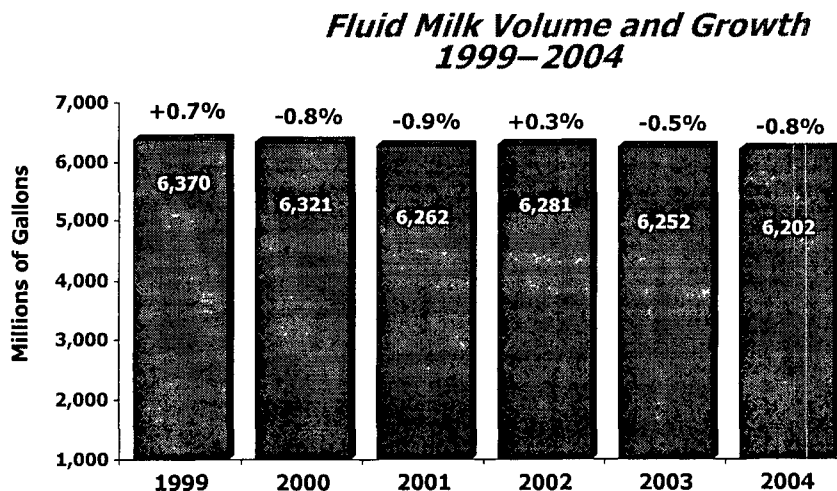
Fluid Milk Market and Promotion Assessment

For the fifth consecutive year, Beverage Marketing Corporation (BMC) has been commissioned by Dairy Management Inc. (DMI) and the National Fluid Milk Processor Promotion Board to review the national fluid milk advertising and promotional programs. This review offers a subjective evaluation of the effectiveness of those programs and provides a third-party marketing perspective of these efforts. It also evaluates milk's position relative to milk's competitive beverage set, including its respective marketing efforts and market performance. BMC believes milk's competitive set includes most non-alcoholic refreshment beverages, specifically carbonated soft drinks, bottled water, fruit beverages, ready-to-drink teas, and sports beverages. This year, BMC examines the overall milk industry's performance as well as the effect that targeted advertising and promotion have had on milk consumption by the crucial demographic cohorts. The following summarizes our findings based on the analysis of available data.

Beverage Marketing Corporation's Assessment of Current Milk Industry Environment

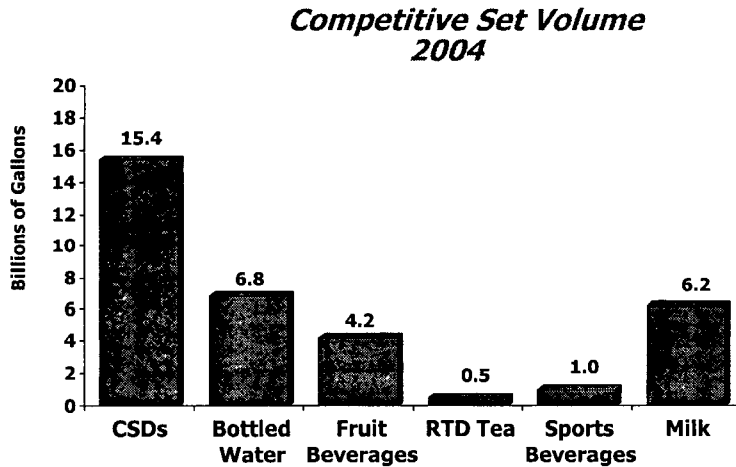
In 2004, fluid milk volume declined by 0.8 percent to 6.20 billion gallons following the slightly downward trend in 2003. Over the last 6 years, fluid milk volume has essentially been stable, fluctuating within a narrow band of volume between 6.2 and 6.4 billion gallons. Milk volume declined 50 million gallons in 2004 and about 30 million gallons in 2003. The history of volume changes for fluid milk sales over the past 6 years is shown in Figure 4-1. Milk's compound annual growth rate (CAGR) for the 5-year period of 1999 to 2004 was -0.5 percent, a reflection of the negligible swings in year-over-year milk consumption since 1999. In fact, these narrow consumption swings from year to year extend back over a decade. Consider that as long ago as 1988 fluid milk consumption was 6.2 billion gallons—almost identical to the fluid milk consumption in 2004.

Figure 4-1



Source: Beverage Marketing Corporation, USDA

Figure 4–2



Source: Beverage Marketing Corporation

Within its competitive set, milk is the third largest beverage category by volume. (See Figure 4–2.) In 2004, bottled water, which has been showing dramatic growth for the last decade, strengthened its position as the second largest beverage category. Meanwhile, carbonated soft drinks remain the largest category in the competitive set by far with 15.4 billion gallons in 2004. With the exception of milk and fruit beverages, all categories experienced some sort of increase over the past year.

As a whole, the combined categories of the competitive set increased by 2.1 percent to 34.1 billion gallons, up from 33.4 billion gallons in 2003. From 1999 to 2004, the competitive set has grown at a CAGR of 1.8 percent. (See Figure 4–3.) Without milk, the performance of the competitive set would have been slightly better—increasing at a CAGR of 2.4 percent from 1999 to 2004. Without bottled water, the competitive set grew by a CAGR of just 0.5 percent over that same 5-year time span. Bottled water accounted for approximately 75 percent of the volume increase of the competitive set in 2004. Absent bottled water, milk’s performance was only slightly weaker than the performance of the competitive set.

BMC has studied milk’s share of the volume increase compared to that of the entire competitive set annually over the last 15 years. This index reveals whether milk has gained or lost competitive share over this time span. This measure of milk’s performance is an index based on its share of competitive volume change, divided by milk’s market share of the competitive set at the onset of the year. An index greater than 1.0 indicates milk is improving its share and thus outperforming the competitive set; an index less than 1.0 reveals that milk’s share of the competitive set is declining. In Figure 4–4, this index is illustrated over a 5-year period for each of the competitive set categories.

Milk has consistently underperformed the competitive set, and has thus lost competitive share each year since 1999 as the diagram illustrates. Conversely, bottled water and sports drinks have consistently outperformed the competitive set and have gained competitive share. Bottled water, in particular, has shown dramatic growth in recent years, driven primarily by heightened consumer demand for healthier beverage alternatives and greater convenience.

Figure 4-3

<i>Volume Growth of Milk and Its Competitive Set 1999–2004</i>				
	<u>Milk</u>	<u>Competitive Set Total</u>	<u>Competitive Set Without Milk</u>	<u>Competitive Set Without Water</u>
1999	0.7%	2.4%	2.9%	1.1%
2000	–0.8%	0.8%	1.3%	0.5%
2001	–0.9%	1.7%	2.3%	0.2%
2002	0.3%	2.6%	3.2%	0.8%
2003	–0.5%	1.9%	2.4%	0.5%
2004	–0.8%	2.1%	2.7%	0.6%
99/04 CAGR	–0.5%	1.8%	2.4%	0.5%

Source: Beverage Marketing Corporation

While there are many factors associated with these consumption trends, advertising expenditures is one factor that is easily measured. In 2004, every category within the competitive set except for ready-to-drink tea (RTD) tea experienced an increase in media spending per gallon (See Figure 4-5.) Just as in previous years, milk is one of the lowest categories in media spending per gallon, with only bottled water and RTD tea spending less per gallon. The milk category spent approximately 2 cents on advertising for every gallon of milk sold, whereas carbonated soft drinks spent approximately 5 cents for every gallon sold. Bottled water's success has been primarily distribution- and consumer-driven and has continued even without significant marketing dollar expenditures in recent years.

In 2004, all categories in the competitive set except for RTD tea spent more on advertising than they did in 2003. Carbonated soft drinks once again accounted for nearly half of all advertising

Figure 4-4

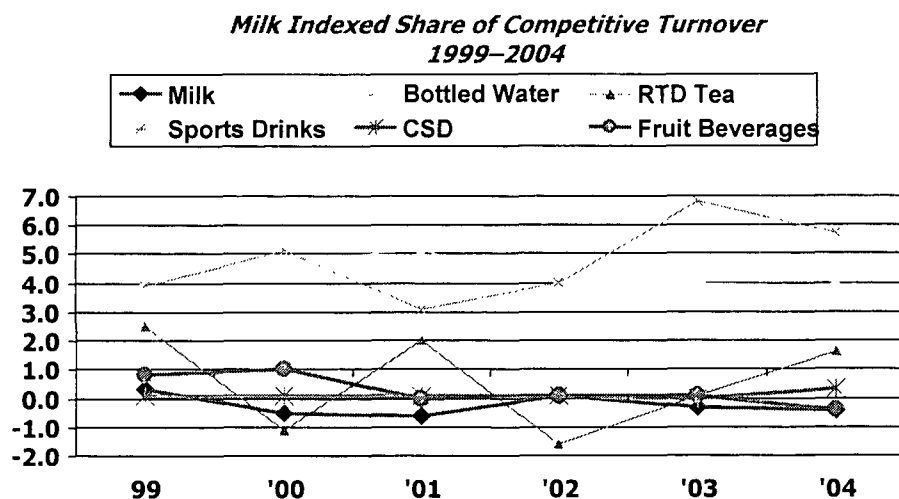
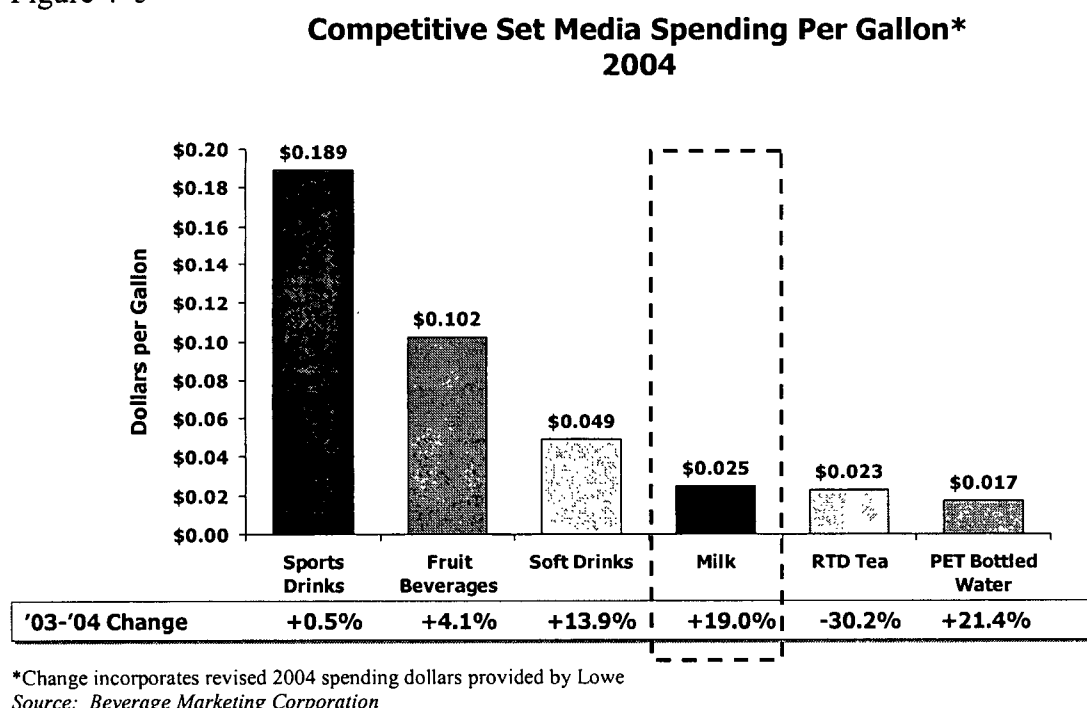


Figure 4-5



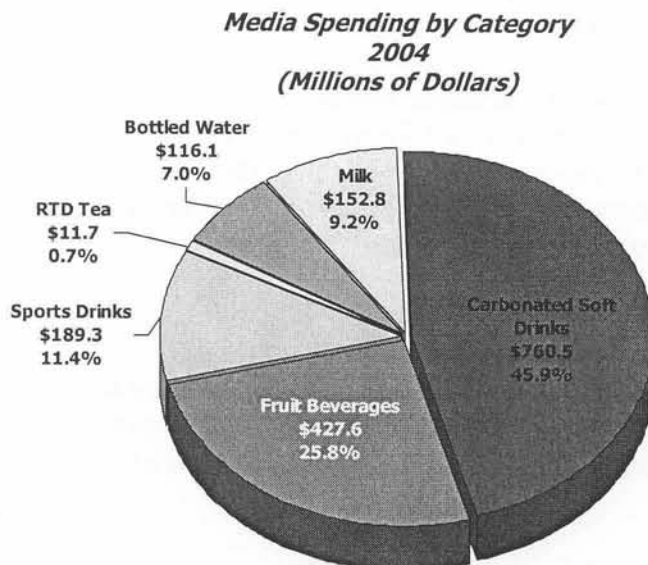
dollars spent within the competitive set, at \$760 million. At \$430 million in spending, fruit beverages accounted for approximately 26 percent. At \$150 million in spending in 2004, milk ranked fourth within the competitive set, accounting for less than 10 percent of spending. (See Figure 4-6.) Milk advertising spending is comprised primarily of the national generic campaign, regional generic spending and branded product spending. While such spending is significant, milk accounts for approximately 18 percent of the competitive set volume and thus, remains significantly underrepresented in share of voice.

Unfortunately, simple measurement of media spending does not take into account the effectiveness of the campaigns, nor does it measure the impact of millions of dollars spent on promotions and other programs. Promotional expenditures can not be measured in an objective manner because it is not tracked by syndicated methods and companies tend not to divulge this data.

Nevertheless, many millions of dollars are spent on promotional programs within the competitive set. BMC believes that milk, despite past year increases in non-media programs, continues to be outspent on promotional programs and that this is a contributory factor to milk's flat volume performance.

Furthermore, the milk category is disadvantaged relative to the other competitive set categories for other reasons, outlined below. While the milk category has begun to make progress in many of these areas, for the most part it continues to trail the other categories in all of them.

Figure 4-6



Source: Beverage Marketing Corporation; Lowe

Consumer Attention

Clearly, consumer awareness and penetration of milk is high; however, the category lacks other competitive categories' high-level of consumer-focused marketing and "news" related to product and brand activities (e.g., promotions, innovations, etc.).

In 2004, milk once again lagged the competitive set in its share of advertising expenditures in contrast to its volume share. Milk's low share of voice, declining over a number of years, is likely to have both real-time immediate as well as a cumulative negative impact on milk consumption.

Beverage product innovation has accelerated in recent years for all categories within the competitive set. Innovation adds news and excitement to categories, bringing more focus and attention to them compared to less innovative categories. Despite innovation in the milk category, milk has lagged other competitive set categories in number of new product introductions. The net result is that consumers have more choices than ever outside of milk. The news related to innovation has the added effect of increasing the impact of advertising. Many of these new products, such as soy beverages or orange juice with calcium, have innovated into milk's territory, co-opting milk's healthy positioning.

Product Attributes and Innovation

Recent innovation in the milk category has centered on flavored milk—primarily variations of chocolate—and single-serve packaging. While this represents an improvement after years of very little innovation, other competitive set categories have been more aggressive with a wider variety of product innovation and a greater assortment of packaging formats and sizes. Among

other innovations, beverage fortification with vitamins, minerals, herbs and other ingredients have added functional benefits in many categories.

In 2004, milk new product introductions stayed low at 202, with no increase over the previous year. Milk ranked third in the competitive set for new product introductions in 2004, behind fruit beverages and carbonated soft drinks, its principal competitors. But the category is in need of more innovation, both evolutionary (e.g., packages and flavors) and revolutionary (e.g., functionality and technology) in the coming years.

Branding

One of the more significant disparities in milk versus its competitive set is the distinct lack of big milk brands and the impact of brand-building support on the total category. In comparison, the competitive set is dominated by mega-brands that have been built and nurtured by world-class marketing organizations.

The milk category is dominated by private label. In 2004, only 31.6 percent of milk volume in the grocery channel was accounted for by branded products. No other category in the competitive set has less than half its volume accounted for by branded products. BMC believes this disparity places milk at a distinct disadvantage with the rest of the competitive set because of the challenges inherent in marketing a category versus brands.

Finally, the high share of private label milk reinforces milk's commodity image, making competitive premium-image products more attractive to consumers.

Distribution

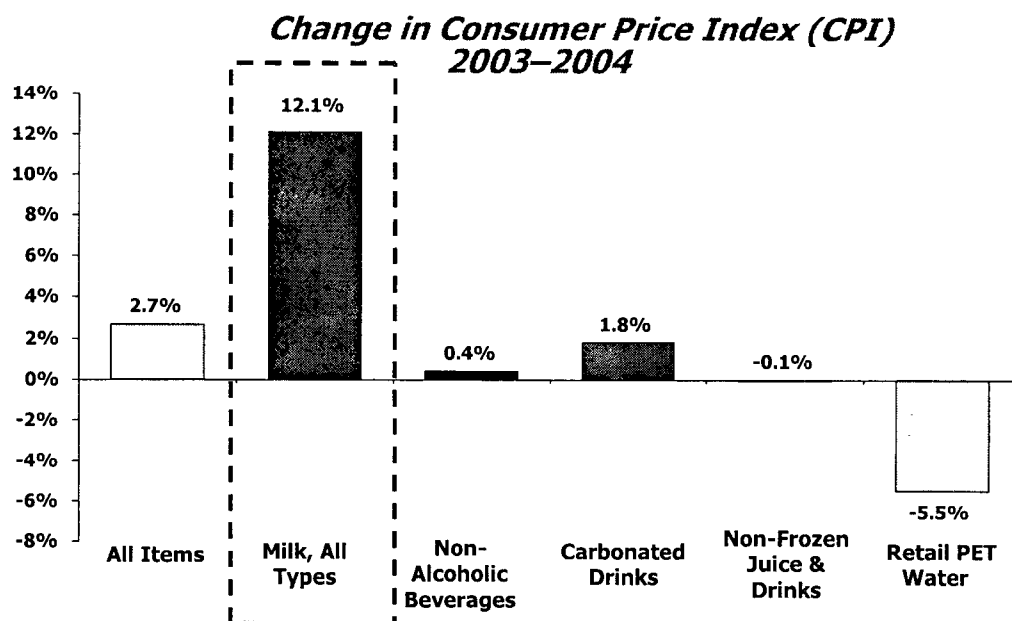
Milk is widely available; nevertheless, its availability does continue to have some significant limitations. Milk availability is concentrated in take-home retail channels, especially supermarkets. In other outlets where milk is available, it often does not have the range of packaging and flavor options that consumers seek and that are offered by other competitive set products. This places milk at a competitive disadvantage.

As consumer lifestyles become more and more on-the-go, beverage manufacturers respond by developing products in convenient single-serve packaging distributed in immediate consumption channels such as convenience stores, foodservice, and vending. In 2004, only about 19 percent of milk volume was sold for immediate consumption, whereas more than half the volume of carbonated soft drinks, sports drinks and ready-to-drink tea was purchased for immediate consumption.

Pricing

Price promotion is a key tool beverage marketers have used to spur sales, and this is true of all categories in the competitive set except for milk. The industry is limited structurally and legally in its use of price promotion.

Figure 4-7



Source: Beverage Marketing Corporation; Bureau of Labor Statistics

In 2004, milk had the largest consumer price index increase of all the categories in the competitive set tracked by the Bureau of Labor Statistics. In particular, the milk category experienced rising prices throughout 2004 and into 2005. Given milk's responsiveness to price changes, these increases are likely to amplify milk's competitive disadvantage. (See Figure 4–7.)

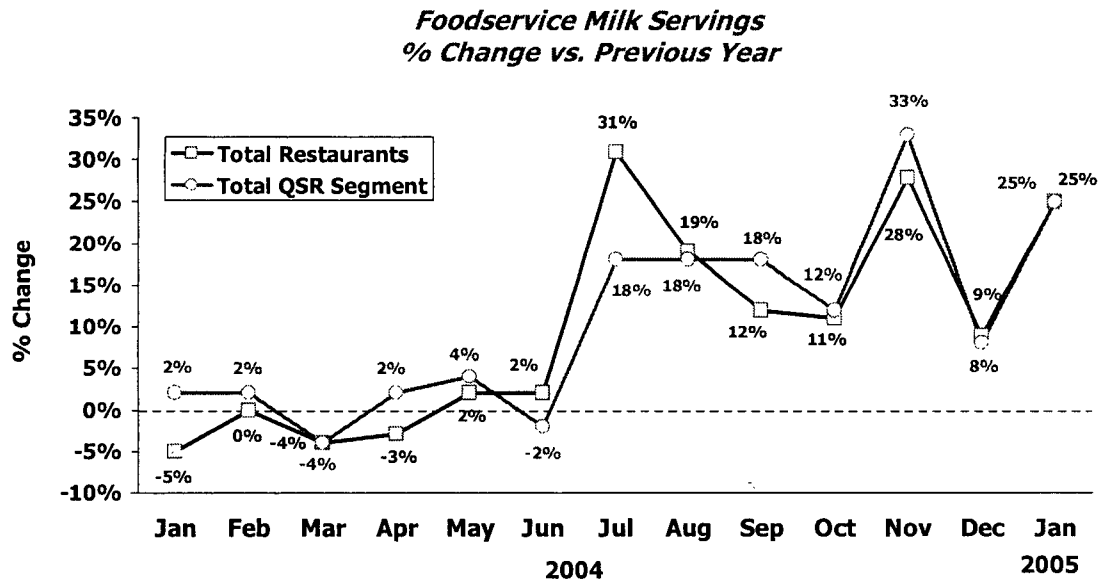
Beverage Marketing Corporation's Assessment of Current Milk Marketing Programs

BMC believes the marketing campaigns developed under the Dairy Production Stabilization Act of 1983 and the National Fluid Milk Promotion Act of 1990 have served to stem declines in milk consumption in the face of vastly heightened competition. While over the last 5 years there has been a decline in milk consumption, BMC believes these declines would have been more significant without the industry's got milk?/Milk Moustache, 3-A-Day™, weight loss, and other generic campaigns.

Of particular interest in 2004 was the emergence of new scientific evidence that milk consumption can be linked to weight loss. This has allowed for an unparalleled opportunity to drive milk sales. With the generic program shifting resources and realigning the advertising budget and other program efforts (e.g., public relations, promotions, and research) behind weight loss communications, there has been measurable success in achieving consumer acceptance of the weight loss-milk link. This success should build into 2005 and beyond. In addition, dairy processors have welcomed the weight loss programming and integrated it into their own business and brand-building initiatives.

In accordance with the new weight loss efforts, there has been a shift in target and product focus. Generic media spending allocations moved from kids and teens to women/moms, with a switch

Figure 4–8



Source: Beverage Marketing Corporation; NPD Group Inc.; Crest

in emphasis from flavors/single-serve to core white milk. The continuation of the got milk?[®] Milk Moustache campaign, driven by new celebrities, is also tied-in with weight loss. Despite the shift away from teen-targeted advertising, grassroots efforts and sponsorships targeted toward teens continued. These efforts also included the 3v3 soccer tournaments, action sports, Disney's Wide World of Sports, and the National Football League partnership.

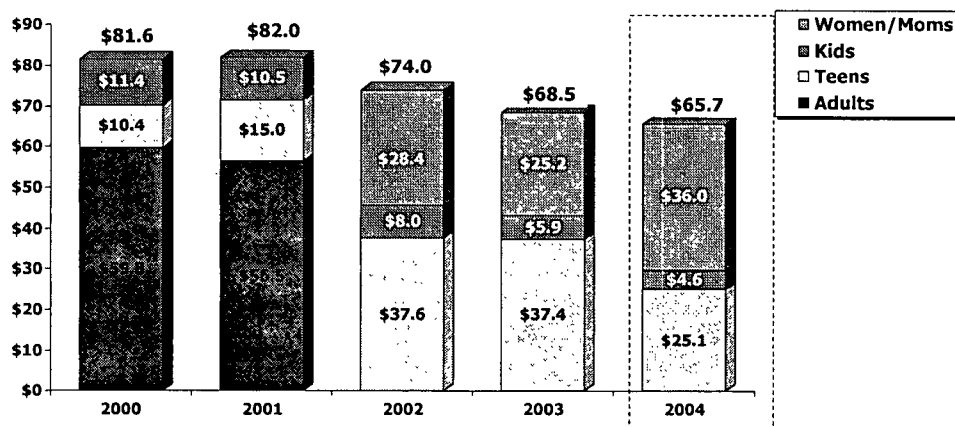
Programs focusing on milk vending, foodservice, and school milk improvements continued in 2004, as did Hispanic consumer-targeted programs. The milk vending initiative appears to be gaining momentum, with BMC estimating there are now roughly 7,500 dedicated milk vending placements, many in the key secondary school channel. Foodservice milk sales, especially through quick service restaurants (QSR), are also gaining traction after the industry-sponsored tests with Wendy's[®] and McDonald's[®]. (See Figure 4–8.)

Even against these improvements, milk remains at a disadvantage against the competitive set. Its price is increasing faster than any other category, while its spending is declining. The last 3 years have seen declines in the fluid milk generic media budget—from \$82 million in 2001 to \$65.7 million in 2004. (See Figure 4–9.) BMC believes this decline in spending may have a negative impact on milk consumption in the face of sizeable spending by other categories in the competitive set. Most of the categories in the competitive set (except bottled water and RTD tea) outspent milk again in 2004. In addition, milk's share of voice is roughly half its volume share of the competitive set.

The new emphasis on weight-loss benefits has also invited new challenges for milk. The set of direct competitors may now include other weight-loss products such as meal replacement beverages and bars, and even programs such as Weight Watchers and Jenny Craig. Additionally, with competitors' aggressive advertising, promotion, and focus on convenience and innovation, milk is perceived as being less contemporary compared to the alternatives.

Figure 4–9

**Fluid Milk Generic Advertising Budget ⁽¹⁾
2000–2004**



(1) These figures represent only national MilkPEP and DMI advertising spending and not Qualified Program spending.
Source: Beverage Marketing Corporation; Lowe

The shift in target to women/moms has lessened milk advertising focus on previously targeted teens/kids. Positive consumption trends were seen with teens/kids in prior years, and the industry should be concerned about losing traction with those consumers. It will be critical for the generic programs to continue to focus or refocus resources toward the primary targets, including teens, while continuing to evolve the messaging. The industry will have to accurately gauge consumer response to the weight-loss message and its sustainability, and eventually evolve or perhaps move onto another benefit communication. Additionally, the focus on weight loss should not be at the expense of other long-term relevant industry platforms, including product innovation, availability enhancements, and significant brand-building focus.

Absent further significant price increases for 2005, the outlook seems promising, especially given the growing acceptance of the weight-loss platform. As long as spending is strong and improvements in availability and promotions continue into 2005, BMC predicts a slight increase or at least stable volume for the upcoming year.